

REBUTTAL TESTIMONY

of

MICHAEL McNALLY

Finance Department  
Financial Analysis Division  
Illinois Commerce Commission

Wisconsin Energy Corporation, Integrys Energy Group, Inc., Peoples Energy, LLC, The  
Peoples Gas Light and Coke Company, North Shore Gas Company, ATC  
Management, Inc., and American Transmission Company, LLC

Joint Application for Approval of a Reorganization  
Pursuant to Section 7-204 of the Public Utilities Act

Docket No. 14-0496

January 15, 2015

**WITNESS IDENTIFICATION**

**Q1. Please state your name and business address.**

A1. My name is Michael McNally.

**Q2. Are you the same Michael McNally who provided direct testimony in this proceeding?**

A2. Yes.

**Q3. Please state the purpose of your rebuttal testimony in this proceeding.**

A3. The purpose of my rebuttal testimony is to respond to the rebuttal testimony of Joint Applicants witness Scott J. Lauber. (JA Ex. 7.0.)

**RESPONSE TO MR. LAUBER**

**Q4. Mr. Lauber repeatedly refers to your proposals as being based on hypothetical scenarios and speculative in nature. (JA Ex. 7.0, 2, 13, 14, 25, 26.) Please respond.**

A4. Of course my proposals are based on hypothetical scenarios, since they are contemplating the unknowable future. Likewise, the Company's contrary assumption that no ill effects will result from the proposed reorganization is every bit as speculative. The simple fact is, no one knows exactly what effects the proposed reorganization will have on Peoples Gas and North Shore Gas (together, the "Gas Companies").

**Q5. You recommended the Gas Companies be required to maintain separate credit facilities. Mr. Lauber proposes to amend that condition to reflect that the Gas Companies should maintain any separate credit facilities to the extent they existed prior to approval of the proposed Reorganization. (JA Ex. 7.0, 15.) Do you agree to the amendment Mr. Lauber proposes to that condition?**

**A5. Yes.**

**Q6. You proposed to require WEC Energy Group to notify the Commission before increasing its proportion of non-regulated operations and indebtedness. Mr. Lauber counter-proposes to require WEC Energy Group to file a copy of its triennial report to the Wisconsin PUC with the ICC. (JA Ex. 7.0, 16-17.) Do you accept Mr. Lauber's counter-proposal?**

**A6. No.** The Joint Applicants' proposed reporting would be too infrequent, given that the Companies can file rate cases more frequently. Further, the Joint Applicants' argument that Staff's proposed condition is unnecessary because the Act already requires the approval of transactions with non-utility affiliates is irrelevant. The issue is not approval of specific transactions with non-utility affiliates. Rather, my concern is that, given the negative credit outlook for WEC Energy Group and the Gas Companies, increasing WEC Energy Group's proportion of non-regulated operations and indebtedness would increase the risk to the Gas Companies of a potential credit rating downgrade and the associated negative effects. As noted in my direct testimony, the purpose of my proposed condition is to permit the Commission to assess whether further action would be necessary to insulate the Gas Companies from their affiliates, should WEC Energy Group decide to increase the potential influence of non-utility affiliates or indebtedness. Triennial reporting would not provide sufficiently timely data.

At the very least, Staff would need to review WEC Energy Group's proportion of non-regulated operations and indebtedness prior to any rate case, to assess the need for further action and prepare solutions for proposal in the rate case. Thus, as a compromise, Staff proposes that WEC Energy Group be required to provide such a report six months prior to any rate case. Should the Joint Applicants feel that the forecasting of rate cases would be too difficult, Staff proposes that, in the alternative, WEC Energy Group simply provide such a report on an annual basis.

**Q7. You proposed to require the Gas Companies to register with the U.S. Securities and Exchange Commission ("SEC") or to present a detailed study showing costs and savings of registration compared to remaining unregistered. Mr. Lauber claims SEC registration would not be cost effective and, thus, rejects that proposal outright. (JA Ex. 7.0, 17.) Please respond to Mr. Lauber's assertion.**

A7. Mr. Lauber asserts that the Gas Companies terminated their previous SEC registration, finding no advantage to SEC registration, given the relatively small size of their debt issuances. Presumably, those decisions were based on some sort of cost/benefit study. If so, it should be fairly easy for the Gas Companies to provide the Commission with a copy of that study. Likewise, it should be a fairly straight-forward endeavor to replicate such a study using current data. And, as indicated in my proposed condition, SEC registration would not be required if such a study confirms Mr. Lauber's claim that registration would not be cost effective.

67 **Q8. You proposed to require the Gas Companies to file a compliance report after**  
68 **the closing of the proposed reorganization identifying any capital structure**  
69 **adjustments that were required as a result of the reorganization. While Mr.**  
70 **Lauber states that as a result of recent changes in accounting regulations**  
71 **push-down accounting adjustments will not be required, he nonetheless**  
72 **does not oppose your proposal and provides suggested language for that**  
73 **reporting requirement. (JA Ex. 7.0, 24.) Is the language Mr. Lauber proposes**  
74 **acceptable?**

75 A8. Yes.

76 **Q9. You proposed to require the Gas Companies to present a study of the**  
77 **appropriate post-merger capital structures for the Gas Companies prior to**  
78 **the filing of the their next rate case, similar to those ordered for ComEd and**  
79 **Ameren Illinois. Mr. Lauber rejects that proposal outright. (JA Ex. 7.0, 24-**  
80 **27.) Please respond to Mr. Lauber's arguments.**

81 A9. In rejecting my proposed condition, Mr. Lauber argues that we will know whether  
82 or not the proposed reorganization has affected the Gas Companies' credit ratings  
83 by the time of their next rate case, rendering an ex ante capital structure study  
84 unnecessary. However, as noted in my direct testimony, a credit rating downgrade  
85 relating directly to the proposed reorganization is not the only concern. (Staff Ex.  
86 7.0, 12, 16.) As shown in the Joint Applicants' own forecasts, WEC's decision to  
87 fund the proposed transaction by significantly increasing its debt obligations at the  
88 corporate level creates higher financial leverage at the parent than at the operating  
89 companies, generating a likely violation of Section 9-230, as it constrains the Gas  
90 Companies' ability to take full advantage of their debt capacities. Further, a full  
91 and proper study of appropriate capital structures for the Gas Companies would

require significant time and effort and, thus, would be best addressed outside the confines of a rate case, during which time there are many other issues to address.

Mr. Lauber also argues that the cause for the ComEd and Ameren Illinois capital structure studies – the adoption of formula rates that severs the relationship between capital structure and rate of return – does not exist in this proceeding. However, while the causes for concern regarding Section 9-230 and, thus, for undertaking such a study may differ, the Commission's charge remains the same: to establish a reasonable capital structure not in violation of Section 9-230 in each company's next rate case. Toward that common end, the ComEd and Ameren Illinois cases merely represent examples of the type of process and report Staff proposes.

Nevertheless, given the efforts required for the type of capital structure study Staff proposes, Staff understands that the Gas Companies may wish to avoid undertaking such a study. Thus, as a compromise, I propose to amend my original condition to waive the proposed study if, by one year prior to the filing of the Gas Companies' next rate case, WEC Energy Group's common equity ratio is greater than or equal to that of the Gas Companies or, in the alternative, if the Joint Applicants commit that the common equity ratio the Gas Companies propose in their ensuing rate cases will be no higher than that of WEC Energy Group.

**Q10. Regarding those alternatives to providing a capital structure study, how should WEC Energy Group's common equity ratio be calculated?**

A10. WEC Energy Group's capital structure should be based on data from its most recently filed annual report to the SEC (i.e., Form 10-K). Specifically, the long-

term debt (including long-term debt due within one year), preferred stock, and common equity balances should be based on end-of-year data from the balance sheet, while the short-term debt should equal the annual average outstanding balance as is currently reported in the notes to the consolidated financial statements. For example, Wisconsin Energy Corporation's most recent 10-K, for the year ending December 31, 2013, indicates a 45.38% common equity ratio based on the following balances:

Capital Component	Amount	Percent of Capital
Short-term debt (average)	\$359,100,000 <sup>1</sup>	3.85%
Long-term debt (total)	\$4,705,400,000 <sup>2</sup>	50.44%
Preferred stock	\$30,400,000 <sup>2</sup>	0.33%
Common equity	\$4,233,000,000 <sup>2</sup>	<b>45.38%</b>
Total	\$9,327,900,000	100.00%

**Q11. The Joint Applicants argue that Mr. Gorman's proposed condition to restrict dividends is unnecessary, as the Commission already is empowered to restrict dividends by Section 7-103 of the Act. (JA Ex. 7.0, 9.) What is your position on the matter?**

A11. I neither favor nor oppose Mr. Gorman's proposal. However, I do note that, unlike Mr. Gorman's proposal, the authority granted the Commission under Section 7-103 is not preemptive. Therefore, if Mr. Gorman's proposed condition is rejected, Staff recommends that the Commission require the Joint Applicants to file copies of all credit rating agency reports for the Gas Companies and WEC Energy Group, so that the Commission can act on its authority under 7-103 in a timely manner should those reports indicate a deterioration in the companies' creditworthiness. Those credit ratings reports should be filed within 5 business days of publication.

<sup>1</sup> Wisconsin Energy Company 2013 Annual Report to the SEC (Form 10-K), 93.

<sup>2</sup> Wisconsin Energy Company 2013 Annual Report to the SEC (Form 10-K), 74.

135    **Q12. Does this conclude your rebuttal testimony?**

136    A12. Yes, it does.